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19 January 1951

MEMORANDUM TO THE FILES

SUBJECT: Tax problems of [redacted] 25X1

25X1 1. The Special Projects Division of OPC recently requested advice concerning the payment of withholding of taxes of nonresident aliens related to [redacted] In discussions with [redacted] 25X1 and Mr. [redacted] 25X1 the following facts have come to light.

2. It is our understanding that more than one hundred nonresident aliens are in this country under the aegis of the N.C.F.E. Most of these people came from satellite countries, and they are either displaced persons without national identity or else they are sponsored by nations providing only the temporary security of a special visa. Normally, they enter the United States on a visitor's visa valid for no longer than 90 days, and a condition of admittance under this visa requires permission from the Immigration and Naturalization Section of the Department of Justice to receive compensation for any services which the alien may render during his stay in the United States.

3. The people with whom we are concerned receive monthly payments which are generally in excess of $300.00. These payments provide for the support of the aliens and their families, but, the aliens are engaged, to an indeterminate extent in research activities and in the preparation of reports. Presumably these reports are of either immediate or future value to the N.C.F.E. There are instances where the alien has also received payment of a fee for a one-time job such as a lecture, report, translation, or radio broadcast. As a matter of fact, a great many, if not all, of the aliens have exceeded the 90 day limit of their visas.

25X1 4. The persons receiving periodic monthly payments were considered by the [redacted] to be of a class more or less arbitrarily designated as "stipendiaries." The intent behind this term is a little vague, but apprently there was some thought of a grant-in-aid. No Federal income tax was withheld from payments made to this class by N.C.F.E., and in a recent situation (which apparently creates no security hazard in itself) the individual was advised by the Collector of Internal Revenue or the Field Agent that a tax should have been withheld by his employer.

5. In order to preserve the security of this project, and to assure compliance with the U. S. tax laws, it is necessary to consider whether (1) the payments are taxable income to the nonresident alien, and (2) whether any tax should be withheld by the employer.

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6. We are primarily concerned with the Federal income tax. In regard to the status of nonresident aliens the law is somewhat complicated and fairly technical, although certain salient points are clear. For tax purposes, nonresident aliens fall within three categories:

First: Those who are not engaged in trade or business within the United States and have fixed or determinable income of not more than $15,400.00 per year;

Second: Those not engaged in trade or business within the United States and having fixed or determinable income or more than $15,400.00 from U.S. sources, and

Third: Those engaged in trade or business in the United States, including working in the United States for salaries or wages.

Nonresident aliens who are "engaged in trade or business" in the United States are taxed upon all income from U. S. sources which are not exempt by treaty. Tax and surtax are computed at the rates applicable to U. S. citizens; he is entitled to deductions to the extent that they are related to income from U. S. sources; and he is allowed a pro-rated exemption of $600.00 regardless of marital status. (There are certain variances for residents of Canada and Mexico.)

7. In general, a nonresident alien who receives compensation for personal services performed in the U. S. is considered as being "engaged in trade or business" within the U. S., subject only to the exception that the alien does not come within this coverage if (a) the services are performed for a nonresident alien individual, foreign partnership or foreign corporation not engaged in trade or business within the U.S.; and (b) the alien is present in the U. S. only for a cumulative period not exceeding a total of 90 days; and (c) compensation does not exceed an aggregate of $3,000.00.

8. In passing, what constitutes "income from U. S. sources" is determined by a somewhat complicated set of rules. For our general use, we can confine it to compensation for services performed within the U. S.

9. The category of non-resident aliens who are not engaged in trade or business within the United States and have fixed or determinable income of not more than $15,400.00 a year are taxed at the rate of 30% on income from U. S. sources consisting of interest, dividends, rents, salaries, wages, compensations, remunerations, among others, and in general any type of fixed or determinable annual or periodic gains, profits and income, including royalties. These items are the only

items of income from U. S. sources subject to tax. However, this type of alien is not allowed any deductions or credits and receives no exemption.

If he is not engaged in trade or business within the U.S. and has fixed or determinable income of more than $15,400.00 fromU. S. sources, the alien is taxed, not at the flat rate of 30%, but at the regular normal tax and surtax rates applicable to U.S. citizens and residents, and the total tax shall never be less than 30%. Income subject to tax is that indicated above for the "less than $15,400.00" group, but as distinguished from them, he is allowed deductions related to such income, and he is entitled to exemptions extended those who are engaged in trade or business.

All deductions and exemptions are allowed only if a return is filed by the nonresident alien; otherwise the commissioner will prepare the return himself, but will not allow deductions or exemptions.

Under the present "pay-as-you-go" tax plan applicable to U. S. citizens and residents, provision is made for withholding of tax at the source for wage and salary payments. This should be distinguished from the far narrower withholding required in payments to nonresident aliens. Regardless of whether the nonresident alien is engaged in trade or business within the U. S., he is subject to withholding at 30% of fixed or determinable annual or periodical income from U. S. sources. Those who are engaged in trade or business in the U. S. are taxed at the regular rate and the 30% withholding is applied as a credit. There are certain exemptions from withholding but they do not include compensation from purely U. S. sources. The person required to withhold and pay the tax must make an annual return on or before 15 March on Form 1042, and pay at that time. Under the old law, the return was required by 15 March, but payment could be deferred to 15 June.

In the case of nonresident aliens, no information return other that that indicated above is required from the employer. The nonresident alien is however required to file a final return if he is engaged in trade or business within the United States, on Form 1040 B. If he is not engaged in trade or business in the United States, but has an income of more than $15,400.00 he must file Form 1040 NB-a. If he is not engaged in trade or business in the United State and has an income of less than $15,400.00 he must file a return on Form 1040 NB, if the tax is not entirely satisfied at the source. As we have already indicated, withholding in the case of those persons not engaged in trade or business in the United States is restricted to fixed or determinable annual or periodical income, and in exceptional cases there may be some question in regard to fees for one-time jobs such as announcing, translating,

or preparation of reports. However, since the performance of personal services, with the related receipt of compensation therefor, operates to place a nonresident alien individual in the category of doing "trade or business" in the United States. This point would seem to be largely moot.

Effective with the 1950 Revenue Act , certain capital gains of a nonresident alien must also be included in gross income as follows:

Rule (1): A nonresident alien who has not been physically present in the United States at any time during his taxable year is not taxable on any capital gains derived in the United States in that year. Nor can capital losses be taken on such transactions.

Rule (2): If a nonresident alien has been present in the United States for less than 90 days during his taxable year, he will be taxable on his net capital gains from sources in the United States, but only on those sales or exchanges which are executed while he is in the United States during such year.

Rule (3): A nonresident alien who has been present in the United States for 90 days or more during the taxable year will be taxable on his net capital gains from United States sources during such year whether or not he was present when such sales or exchanges were consummated (Code Sec. 211(a)(1)(B).

The 30% rate is applied to the excess of recognized gain over capital losses in addition to the tax which is owed on the items of income of nonresident aliens not engaged in trade or business in the United States. In determining the gain to which the 30% is applicable, no reduction for long-term gains or losses is permissible. Regardless of whether the gain is long or short-term, it must be taken into account 100% and this is equally true of capital losses. The five year capital loss carry-over is not extended to nonresident aliens for this purpose. In reaching a final determination of the aggregate amount of income, capital gains and losses are fully taken into account, but once the total income has been computed in excess of $15,400.00, the appropriate rules apply. Only 50% of long-term gains and losses is taken into account and the alternative tax is applicable but the total liability may in any event be less than that computed at the flat rate of 30%. These provisions are effective for tax years beginning after 31 December 1949.